

## **Too Much Cash**

---

by Karen M. Kroll

Although many companies' cash balances have grown over the past few years, finance executives are taking a measured, disciplined approach to using those funds.

Global apparel giant VF Corp. cuts a stylish figure in the world of fashion with a striking collection of brands that includes Nautica sportswear and Vans outdoor gear. Lately, its balance sheet has been looking pretty sharp, too. At the end of 2004, the Greensboro, N.C.-based company was carrying \$486 million in cash and equivalent investments. And that was after spending approximately \$600 million on three acquisitions -- Vans, Green Sport Monte Bianco S.p.A. and Kipling Belgium NV -- within 12 months. What's driving VF's fashion-forward balance sheet is the cash flow capacity of its businesses, says Bob Shearer, CFO and vice president of finance and global processes. In 2004, the company generated \$6 billion in revenue and accumulated some \$730 million in cash. Its debt level remained basically flat throughout the year.

VF has set its sights on top-line growth of between \$2 billion and \$3 billion over the next five years, Shearer reports, and its cash assets will play a key role in helping it achieve that goal. The expansion will be about evenly split between acquisitions and organic growth. "When you generate a lot of cash, you can make acquisitions and still keep the balance sheet strong," Shearer points out.

VF is not the only organization that's currently enjoying an ample cash cushion, according to research from Standard & Poor's. The 376 industrial companies in the S&P 500 collectively had \$626 billion in cash on their balance sheets at year-end 2004, up 25 percent from \$500 billion at the end of 2003, reports Howard Silverblatt, market equity analyst in the credit

rating and research provider's New York City headquarters. "We've never seen this amount of cash," he says.

While several factors account for the jump, Silverblatt emphasizes two: Strong earnings at many organizations last year boosted corporate coffers. And some companies were able to leverage tax loss carry-forwards and credits, so more earnings hit their bottom line.

Corporate liquidity will remain strong this year and into 2006, predicts Marc Loneux, London-based chief analyst with REL Consultancy Group. But finance executives are resisting the urge to indulge in shopping sprees and frivolous investments, he says. Instead, they are taking a disciplined approach to deploying their cash. "It's an interesting picture today; companies are much more cautious despite their improved liquidity," he observes.

In part, this restraint is a result of pressure from shareholders and credit-rating agencies, says Loneux. These constituents want to ensure that businesses don't repeat the mistakes of the past, such as overpaying for acquisitions. Historically, hefty cash balances have tended to cloud companies' judgment. "Having cash around can lead to managerial slack," notes Hans Stoll, professor of finance in Vanderbilt University's Owen Graduate School of Management in Nashville, Tenn.

At the same time, shareholders are well-aware that cash balances contribute little to earnings. At press time, the 30-day average annualized yield on money market funds was just over 2 percent. Shares of companies that sit on mounds of cash often trade at a discount compared with those of their peers, notes Loneux.

For CFOs looking to deploy excess liquidity, success lies in striking a balance between investments that will grow the business -- mergers and acquisitions (M&A) or capital equipment purchases, for example -- and initiatives that will put money directly into shareholders' pockets, such as paying dividends.

## Unlocking The War Chest

As VF's experience shows, an ample cash balance adds muscle to companies' M&A strategy. Of course, "you don't want to execute deals just because you have cash," notes Craig Jeffery, managing director with consulting firm Strategic Treasurer LLC in Atlanta. "But if you have the cash and there's a strategic fit for the merger, you now have the flexibility to do it."

International Rectifier, a power management technology provider based in El Segundo, Calif., has decided to stake out a dominant position in its industry, and savvy cash management is key to achieving that goal, says executive vice president and CFO Michael McGee. Between 2000 and 2004, the company's cash balance more than tripled, zooming from \$254 million to \$836 million. "To be in a leadership position, you need to be able to invest in your strategy through good and bad times," McGee observes.

International Rectifier is constantly on the alert for opportunities to purchase or develop new technologies. "The semiconductor industry is an extremely fast-moving industry, and the first to market with the best solution gets the competitive edge," says company spokesperson Graham Robertson. International Rectifier's cash resources confer a crucial advantage in the M&A marketplace. "When you've got a cash war chest, people pay attention," McGee points out.

McGee looks at about 40 acquisition candidates for each deal that he pursues. Targets must fit International Rectifier's strategy, and they must meet its hurdle rate, a minimum initial ROI that ranges between 20 percent and 28 percent.

The company's customers pay close attention to its balance sheet. International Rectifier supplies its products on a multiyear, sole-source basis to some clients. For instance, automobile manufacturers may use one of the company's semiconductors in a particular model for a five- to seven-year period; understandably, they want some assurance that

International Rectifier will be around for the long haul. "They won't work with us unless we have significant cash because they're betting a [product] platform on our ability to deliver," says McGee.

Many cash-flush companies are channeling liquidity into high-ROI capital and IT projects as well as M&A. VF, for example, has been investing in systems that enhance its ability to source and manufacture its products and control its inventory, improvements that should boost cash generation. Its purchases include two supply chain management applications, one from i2 Technologies and one from Logility. VF has implemented both systems in all of its business lines over the past few years.

These tools enable VF to more effectively monitor its operations, performance, working capital and inventories enterprisewide. The company can now tailor its inventory to individual stores; for example, it can stock innovative styles in outlets located in college towns. "When you control inventory, you control cash," Shearer observes. The company's capital investments currently run about \$100 million annually, he adds.

### Making Investors Smile

As corporate cash balances continue to swell, a significant shift is occurring in organizations' investor relations strategies: Dividends are coming back into fashion. "I think everyone fell off their chairs when Microsoft said they would pay a dividend," says Claudia Volk, principal with treasury consulting firm CJVolk Associates Inc. in Arlington, Va. She's referring to the software titan's July 2004 announcement that, for the first time in its history, it would pay out \$3 per share. But Microsoft now has plenty of company on the dividend bandwagon; Standard & Poor's forecasts that the S&P 500 collectively will distribute \$203 billion in dividends this year, up more than 12 percent from \$181 billion in 2004.

A key reason for the increasing popularity of dividends is a 2003 tax law change. Before the law was passed, most dividend income was taxed at a taxpayer's highest marginal

rate, which can hit 35 percent. Now the maximum rate for most dividend income is 15 percent.

"Companies are getting smart and realizing that investors are looking for dividend yield," reports James Sagner, managing principal with consulting firm Sagner/Marks in White Plains, New York. Businesses that pay dividends tend to outperform other companies over time, according to Standard & Poor's. From January 2002 through mid-February 2005, dividend payers in the S&P 500 returned an average of 10.35 percent, compared with 9.86 percent for non-dividend payers. At VF, dividends are "an important element to a significant portion of our shareholder base," says Shearer. The company has distributed dividends ever since it went public in 1951, he reports.

By going the dividend route, businesses are achieving more than putting a smile on investors' faces: They're doing right by the economy, according to some experts. "Ultimately, shareholders are most efficient in allocating cash to its best uses," says Stoll.

Dividends may also benefit the companies that pay them. "Dividend issuers are less volatile than [companies] that don't pay dividends," notes Silverblatt. While stocks of organizations that pay dividends gain less value in bull markets, they also lose less in bear markets. Overall returns from dividend-issuing companies vary within a tighter range than those from non-issuers do. In 2002 and 2003, average returns from dividend payers in the S&P 500 ranged from a loss of 11 percent to a gain of 33 percent, says Silverblatt. The corresponding figures for non-payers were a 31 percent loss and a 62 percent gain.

Like dividends, stock buybacks are on the rise, Silverblatt reports. Preliminary numbers from Standard & Poor's research indicate that share buybacks hit a record \$197 billion in 2004, jumping 50 percent from 2003's \$131 billion.

Companies often use buybacks to offset dilution -- the watering-down of their shares' value that occurs when they

issue stock option grants. EMC Corp., a Hopkinton, Mass.-based provider of information storage and management products and services with \$8.2 billion in annual revenue, is a case in point. Last year, the company bought back approximately 1 billion of its shares to return cash to shareholders and offset dilution resulting from the exercise of stock options by employees, according to Irina Simmons, senior vice president and treasurer.

### Strategies for The Short Term

Interest rates are trending upwards: Between June 2003 and March 2005, the federal funds rate rose from 1 percent to 2.75 percent. Savvy treasurers are monitoring that slope and looking for opportunities to adjust their short-term investment strategies in order to pull bigger returns from their liquid assets.

If rates continue to rise, corporate liquidity will likely decline because businesses will move cash into various investment vehicles, says Chrystal Pozin, senior consultant with Treasury Strategies Inc. in Chicago. She predicts that companies will start to pull cash out of money market mutual funds, which accounted for 36 percent of respondents' portfolios in Treasury Strategies' 2004 U.S. Corporate Liquidity Survey Results, a study of 362 companies representing \$65 billion in cash and investments.

Treasurers will funnel more money into commercial paper, predicts Pozin. And they'll also use more repurchase agreements ("repos"). These are transactions in which one party sells a security to another -- to a cash-rich treasury, in this case -- while also agreeing to repurchase it at a specified date and price in the future. "Commercial paper and repos tend to perform better than mutual funds in a rising-rate environment, as the rates on funds lag the market rates," Pozin explains.

In addition, companies will likely move cash into investments with short maturities so that they can reinvest as rates

increase. "A lot more people are doing 'ladder portfolios,' with maturities of 30, 60, 90 and 120 days," says Mike Orzechowski, sales manager, money center, with Minneapolis-based U.S. Bank. "They get immediate pickup in yield, but they're still not locking up all their cash."

These strategies may not become widespread for a while yet, however. The Treasury Strategies research found that many organizations failed to quickly adapt to the low-interest-rate environment that prevailed last year. More than 60 percent of respondents reported that their company had not adjusted its portfolio's maturities or credit quality in response to lower rates.

Sagner questions just how much leeway companies have when it comes to structuring their short-term investments. "In the context of Sarbanes-Oxley, almost every company has very rigid investment guidelines," he says. "There's certain investment-grade stuff they have to buy."

Focusing on The Forecast

Whether a company decides to spend or save its money, discipline remains key. Treasurers must continue to forecast inbound cash and the liquidity their organization needs for its operations. "When companies are cash-flush, it can make the corporate treasury a bit lazy," warns Strategic Treasurer's Jeffery. "The fact that you have more cash doesn't mean you don't need to forecast."

To be sure, when interest rates are low, grasping for an extra



five or 10 basis points may be more work than it's worth. The real gains are in strategies that boost working capital, such as compressing days sales outstanding (DSO), says Jeffery. "If you take your eye off working capital, accounts receivable and DSO will creep up and use [it] up," he cautions.

Treasurers who don't forecast may decide to play safe and invest only in the short term in order to maintain a cushion. But that will probably mean settling for a lower yield than they might obtain by going further out. At press time, the average yield on six-month Treasuries was 3.12 percent, compared with 2.85 percent for three-month Treasuries.

Forecasting is key to EMC's cash management and investment practices, says Simmons. At the end of 2004, her company held \$2.7 billion in cash and short-term instruments along with \$4.7 billion in vehicles that are conservatively classified on its balance sheet as long-term investments, but which are in fact very liquid, high-quality instruments, such as U.S. government obligations.

These resources will help EMC fund acquisitions. Simmons reports that the company's president and CEO, Joe Tucci, "has been vocal in indicating that EMC will continue to acquire companies that fit into our [corporate] strategy." EMC snapped up 16 software and technology businesses between 1998 and 2004.

"My job is to stay close to the business units and make judgments -- to take care of the dollars so that we can meet our operating and strategic objectives," Simmons says. To do that, she obtains weekly or monthly updates on performance and sales from the heads of EMC's operating units. "The cash flow forecast is almost a real-time assessment of our cash position," she reports.

Deploying the company's cash resources to best advantage will take careful thought, and Simmons will approach the task with discipline. "While it's a nice problem to have," she says, "we take management of this asset very seriously."

Originally printed in the June 2005 issue of Business Finance  
Site Use Agreement :: Privacy Policy :: Media Kit :: Copyright ©  
2005 Penton Media, Inc.